In the Supreme Court of the United States

OCTOBER TERM, 1969

No. 507

BAY SOUND TRANSPORTATION CO., ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Add. 1-15)[1] is officially reported at 410 F. 2d 505. The opinion of the district court (Add. 19-96) is not officially reported.

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[1] "Add." references are to the separately bound "Addendum to Petition for Writ of Certiorari". "I-R.", "II-R.", etc., references are to the "Transcript of Record" in the court of appeals.

JURISDICTION

The judgment of the court of appeals was entered on April 30, 1969 (Add. 16-17), and the petition for rehearing was denied on May 30, 1969 (Add. 18). The petition for a writ of certiorari was filed on August 25, 1969. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether the court of appeals erred in remanding the case for findings as to whether the 20 corporate petitioners were formed for the principal purpose of tax avoidance so that the tax advantages usually available to multiple corporations should be denied under Section 269 of the Internal Revenue Code of 1954.

2. Whether the determination of the district court, affirmed by the court of appeals, of useful lives for petitioners' tugboats and barges for depreciation purposes is supported by the record.

STATUTES AND REGULATIONS INVOLVED

The pertinent parts of Sections 11, 167, 269 and 1551 of the Internal Revenue Code of 1954, and of Treasury Regulations on Income Tax (1954 Code), Section 1.167(a)-1, are set forth in the Appendix, *infra*, pp. 8-14.

STATEMENT

I

Petitioners, 20 corporations and six non-corporate taxpayers are engaged in the transportation of crude

oil and petroleum products (Add. 22, 30). The corporate petitioners are commonly controlled (Add. 45-53), and each of them was organized to acquire one tugboat or barge (Add. 53). Petitioners' vessels were operated as an integral part of a single fleet out of common offices by common personnel and without regard to their separate corporate ownerships other than for bookkeeping purposes (Add. 55-58).

Key personnel in petitioners' organization were aware of the tax advantages of spreading income from one business over several corporations, having been counseled regarding multiple surtax exemptions [2] by a taxation specialist of a national certified public accounting firm (Add. 58-59, 60). The key personnel also were counseled to limit potential tort liability through the use of multiple corporations (Add. 61-62).

The Commissioner disallowed the multiple surtax exemptions of the 20 corporations on the ground that the corporations were formed for "the principal purpose" of tax avoidance within the meaning of Section 269 of the Internal Revenue Code of 1954 (Add. 3-4). At trial, the government also contended that the multiple surtax exemptions should be disallowed under Section 1551 of the Code, on the ground that "a major purpose" of each corporation's acquisition of a single vessel was tax avoidance (I-R. 54).

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[2] Under Section 11 of the Internal Revenue Code of 1954, the first $25,000 of a corporation's taxable income is exempt from the corporate surtax and thus is subject to tax at a lower rate than taxable income in excess of $25,000. Under Section 535(c), an exemption from the accumulated earnings tax is allowed to each separate corporation.

The district court concluded, favorably to the government, that the corporate petitioners failed to establish that they were organized other than for the purpose of tax avoidance. Its opinion was unclear, however, as to whether the disallowance was under Section 269 or Section 1551. (Add. 72-74.)

The court of appeals held that the district court had disallowed the exemptions under Section 1551, and that such disallowance was erroneous in that there was insufficient proof that the vessels had been acquired by the corporate petitioners from a corporation, a requirement of Section 1551. On this issue the case was reversed and remanded for the district court to make findings on the question whether, under Section 269, "the principal purpose" for the formation of the corporate petitioners was tax avoidance. (Add. 12-15.)

II

Petitioners claimed depreciation on their tugboats and barges using a useful life of seven years and on the assumption that after seven years the vessels had no salvage value. The Commissioner maintained that petitioners' estimates were not "reasonable" as required by Section 167(a) of the Code. At trial and in amended answers the government contended that the tugs had a useful life of 35 years, the barges a useful life of 25 years and that salvage value of ten percent should be assigned to both types of vessels. (Add. 70-71.)

The district court found that four of the tugs had a useful life of 15 years, the remaining tugs a use-

ful life of 20 years and that a ten percent salvage should be assigned to all tugs. It concluded that the barges had a useful life of 15 years and did not find a salvage value for these vessels. (Add. 72). In determining the useful lives and salvage to be allowed, the court considered petitioners' experience with tugs and barges, conditions existing in the tax years involved and probable future developments, including technological developments, changes in design of the barges, areas and types of water in which the boats may operate, changes in types of cargo, deterioration in the maintenance of the boats and obsolescence (Add. 28-30, 33-34, 44). It heard testimony of expert witnesses whose opinions as to the appropriate useful lives ranged from six to 30 years (II-R. 503, 611; III-R. 806-807, 842-844, 944, 1116, 1147-1168).

On appeal, petitioners argued, *inter alia*, that the district court had given undue weight to petitioners' experience showing that few of its pre-1955 vessels had been retired from service and insufficient weight to a report prepared by Internal Revenue Service engineers that supported petitioners' position (Add. 5, 9). The court of appeals concluded, however, that the district court had considered significant factors other than petitioners' experience and that it was within the province of the trier of fact to weigh the Internal Revenue Service report together with other expert testimony (Add. 8-9). The Fifth Circuit affirmed the district court's findings as not clearly erroneous (Add. 11).

ARGUMENT

The decision below turns solely on an evaluation of the evidence. There is no conflict of decisions or other ground for further review.

1. The court of appeals correctly held with respect to the multiple corporations issue (Add. 14-15) that since the district court had not made findings on the question of "the principal purpose" for the acquisitions under Section 269, the case should be remanded to that court for appropriate findings. This is no more than is required under Rule 52(a) of the Federal Rules of Civil Procedure. Although petitioners seek certiorari on this issue, they suggest no reason for review by this Court and acknowledge that such review would be "premature" (Pet. 13).

2. Petitioners' arguments on the depreciation issue are similarly lacking in merit. In determining the useful lives of the tugs and barges, the district court was applying to a particular set of facts the established principle that depreciation is intended to be a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in a trade or business or for the production of income. See Treasury Regulations, Section 1.167(a)-1(b), Appendix, *infra*, pp. 13-14; *Massey Motors* v. *United States*, 364 U.S. 92; *Hertz Corp.* v. *United States*, 364 U.S. 122. The court of appeals' holding that the district court's findings are not clearly erroneous likewise was routine. The case thus comes within the settled principle that in the absence of extraordinary circumstances, this Court will not review facts

found by a trial court that are affirmed on appeal. *Comstock* v. *Group of Investors*, 335 U.S. 211, 214.

Contrary to petitioners' assertions (Pet. 10, 13, 15), there is no conflict with *United States* v. *Ludey*, 274 U.S. 295, or *Burnet* v. *Niagara Falls Brewing Co.*, 282 U.S. 648. These authorities and "National Treasury Department Policy" (Pet. 11) require that a taxpayer's estimates of useful lives and salvage for depreciation purposes be reasonable and that such reasonableness be established by the preponderance of the evidence. Here it was held on the evidence that petitioners failed to make the requisite showing.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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APPENDIX

Internal Revenue Code of 1954:

SEC. 11. TAX IMPOSED.

(a) *Corporations in General.*—A tax is hereby imposed for each taxable year on the taxable income of every corporation. The tax shall consist of a normal tax computed under subsection (b) and a surtax computed under subsection (c).

(b) [as amended by Sec. 2, Tax Rate Extension Act of 1959, P.L. 86-75, 73 Stat. 157] *Normal Tax.*—

(1) *Taxable years beginning before July 1, 1960.*—In the case of a taxable year beginning before July 1, 1960, the normal tax is equal to 30 percent of the taxable income.

* * * *

(c) *Surtax.*—The surtax is equal to 22 percent of the amount by which the taxable income * * * exceeds $25,000.

* * * *

[26 U.S.C. (1958 ed.) 11.]

SEC. 167. DEPRECIATION.

(a) *General Rule.*—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

(b) *Use of Certain Methods and Rates.*—For taxable years ending after December 31, 1953, the term "reasonable allowance" as used in subsection (a) shall include (but shall not be limited to) an allowance computed in accordance with regulations prescribed by the Secretary or his delegate, under any of the following methods:

(1) the straight line method,

(2) the declining balance method, using a rate not exceeding twice the rate which would have been used had the annual allowance been computed under the method described in paragraph (1),

(3) the sum of the years-digits method, and

(4) any other consistent method productive of an annual allowance which, when added to all allowances for the period commencing with the taxpayer's use of the property and including the taxable year, does not, during the first two-thirds of the useful life of the property, exceed the total of such allowances which would have been used had such allowances been computed under the method described in paragraph (2).

Nothing in this subsection shall be construed to limit or reduce an allowance otherwise allowable under subsection (a).

(c) *Limitations on Use of Certain Methods and Rates.*—Paragraphs (2), (3), and (4) of subsection (b) shall apply only in the case of property (other than intangible property) described in subsection (a) with a useful life of 3 years or more—

(1) the construction, reconstruction, or erection of which is completed after December 31, 1953, and then only to that portion of the basis which is properly attributable to such construction, reconstruction, or erection after December 31, 1953, or

(2) acquired after December 31, 1953, if the original use of such property commences with the taxpayer and commences after such date.

* * * * *

[26 U.S.C. 167.]

SEC. 269. ACQUISITIONS MADE TO EVADE OR AVOID INCOME TAX.

(a) *In General.*—If—

(1) any person or persons acquire, or acquired on or after October 8, 1940, directly or indirectly, control of a corporation, or

(2) any corporation acquires, or acquired on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately before such acquisition, by such acquiring corporation or its stockholders, the basis of which property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation,

and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy,

then such deduction, credit, or other allowance shall not be allowed. For purposes of paragraphs (1) and (2), control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of the corporation.

(b) *Power of Secretary or His Delegate To Allow Deduction, etc., in Part.*—In any case to which subsection (a) applies the Secretary or his delegate is authorized—

(1) to allow as a deduction, credit, or allowance any part of any amount disallowed by such subsection, if he determines that such allowance will not result in the evasion or avoidance of Federal income tax for which the acquisition was made; or

(2) to distribute, apportion, or allocate gross income, and distribute, apportion, or allocate the deductions, credits, or allowances the benefit of which was sought to be secured, between or among the corporations, or properties, or parts thereof, involved, and to allow such deductions, credits, or allowances so distributed, apportioned, or allocated, but to give effect to such allowance only to such extent as he determines will not result in the evasion or avoidance of Federal income tax for which the acquisition was made; or

(3) to exercise his powers in part under paragraph (1) and in part under paragraph (2).

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[26 U.S.C. (1958 ed.) 269.]

SEC. 1551 [as amended by Sec. 205, Small Business Tax Revision Act of 1958, P.L. 85-866, 72 Stat. 1606, 1676, 1680]. DISALLOWANCE OF SURTAX EXEMPTION AND ACCUMULATED EARNINGS CREDIT.

If any corporation transfers, on or after January 1, 1951, all or part of its property (other than money) to another corporation which was created for the purpose of acquiring such property or which was not actively engaged in business at the time of such acquisition, and if after such transfer the transferor corporation or its stockholders, or both, are in control of such transferee corporation during any part of the taxable year of such transferee corporation, then such transferee corporation shall not for such taxable year (except as may be otherwise determined under section 269(b)) be allowed either the $25,000 exemption from surtax provided in section 11(c) or the $100,000 accumulated earnings credit provided in paragraph (2) or (3) of section 535(c), unless such transferee corporation shall establish by the clear preponderance of the evidence that the securing of such exemption or credit was not a major purpose of such transfer. * * *

[26 U.S.C. (1958 ed.) 1551.]

Treasury Regulations on Income Tax (1954 Code):

Sec. 1.167(a)-1. *Depreciation in general.*

(a) *Reasonable allowance.* Section 167(a) provides that a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business or of property held by the taxpayer for the produc-

tion of income shall be allowed as a depreciation deduction. The allowance is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), so that the aggregate of the amounts set aside, plus the salvage value, will, at the end of the estimated useful life of the depreciable property, equal the cost or other basis of the property as provided in section 167(g) and § 1.167(g)-1. An asset shall not be depreciated below a reasonable salvage value under any method of computing depreciation. However, see section 167(f) and § 1.167(f)-1 for rules which permit a reduction in the amount of salvage value to be taken into account for certain personal property acquired after October 16, 1962. See also paragraph (c) of this section for definition of salvage. The allowance shall not reflect amounts representing a mere reduction in market value. See section 179 and § 1.179-1 for a further description of the term "reasonable allowance."

(b) *Useful life.* For the purpose of section 167 the estimated useful life of an asset is not necessarily the useful life inherent in the asset but is the period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business or in the production of his income. This period shall be determined by reference to his experience with similar property taking into account present conditions and probable future developments. Some of the factors to be considered in determining this period are (1) wear and tear and decay or decline from natural causes, (2) the normal progress of the art, economic changes, inventions, and current

developments within the industry and the taxpayer's trade or business, (3) the climatic and other local conditions peculiar to the taxpayer's trade or business, and (4) the taxpayer's policy as to repairs, renewals, and replacements. Salvage value is not a factor for the purpose of determining useful life. If the taxpayer's experience is inadequate, the general experience in the industry may be used until such time as the taxpayer's own experience forms an adequate basis for making the determination. The estimated remaining useful life may be subject to modification by reason of conditions known to exist at the end of the taxable year and shall be redetermined when necessary regardless of the method of computing depreciation. However, estimated remaining useful life shall be redetermined only when the change in the useful life is significant and there is a clear and convincing basis for the redetermination. For rules covering agreements with respect to useful life, see section 167(d) and § 1.167(d)-1.

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[26 C.F.R. 1.167(a)-1.]

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